COUNTY OF MILWAUKEE
Inter-Office Communication

Date: September 20, 2004

To: Supervisor Richard D. Nyklewicz, Jr., Chairman, Finance and Audit Committee

From: Jerome J. Heer, Director of Audits, William Domina, Corporation Counsel
Steve Cady, Fiscal & Budget Analyst, County Board Staff

Subject: Underwriter Selection Process (File No. 04F8)

Background
On July 22, 2004, the Committee on Finance and Audit reviewed a report by Virchow Krause and Company regarding the process used by Milwaukee County to sell bonds in the summer of 2003. The report identified several opportunities for improvement in the manner in which the County selects and pays for services related to bond sales. The Committee referred the report to the Department of Audit, Corporation Counsel and County Board staff for additional clarification on ways to improve the process. Further, the Committee stated an interest in the manner in which other governments make similar contract awards. The Committee also questioned the payment of $20,000 for July 2003 bond sale services beyond the amount originally presented to the Committee in December 2002.

Analysis
Virchow Krause's July 21, 2004 report noted that debt administration service contracts are not governed by County professional services ordinances. The Department of Administrative Services did, however, substantially follow procedures defined in Chapter 56 of the ordinances. The Virchow Krause report included the following recommendations to improve this process in the future:

- The County should continue to have professional services proposals such as those for bond sales reviewed and evaluated by a review panel with diverse backgrounds.

- The review panel should score proposals based on criteria included in the RFP.

- Ranking technical qualifications is subjective. This criterion should be ranked by the financial advisor and at least one other independent person with appropriate knowledge.

- In evaluating and comparing prices submitted in proposals, all price components should be considered. In instances where the total price is not the appropriate criteria to use, there should be a written explanation of the reasons for deviating from normal practice.

- In order for a proposal to be considered, it must comply with all requirements of the RFP. If it is determined that a proposal materially complied with an RFP, but there were deviations, there should be a written report on the reasons for any deviations.

- Scores should be added up to determine who received the highest score for recommendation of award, so that subjectivity can not over ride a numerical ranking.

- Score sheets should be completely filled out, signed and dated by the review panel members.

- Minutes of the evaluation team meeting should be taken, creating a record of both the discussion of the proposals and the decisions made. Further, we recommend that the panel members score sheets be collected and retained in the file as supporting evidence of the decisions made.

- The review panel's decision should be given to the Director of Administrative Services in writing with said report showing the ranking and scores of all proposals, along with a copy of the minutes of the review panel meeting.

- The County has a records retention policy in addition to the State Statute regarding public records. Some County employees interviewed were not aware of these requirements. We recommend that basic training on these requirements be provided to employees who are responsible for records.

- We do not think it is a reasonable expectation for elected officials to have remembered the original price quotation from six months earlier. Therefore, we recommend that a more complete report be given to elected officials that outline all material changes in conditions prior to final actions being taken by elected officials.

We concur with the Virchow Krause recommendations. However, the merits of scoring proposals over ranking proposals is open to debate. Either process could be manipulated. Neither process can substitute for good judgement. Whichever method departments choose, the evaluation of proposals should be based on clear criteria applied in a fair manner with documented support of the final outcome.

Procedures in Other Jurisdictions
We obtained information on the processes used by other jurisdictions to select underwriters for negotiated bond sales. Most local government jurisdictions responding to our query indicated that they do not engage in negotiated sales. Their debt demands are routine enough in nature to accommodate competitive sales, even for issuances as large as $100 million.

Larger, more complex government (including the State of Wisconsin) generally use a standard proposal process to obtain underwriters for negotiated sales issuances. The major difference is a pattern of selecting a pool of securities firms to act as lead managers or co-managers on a rotating basis for securities issued over a specified period of time. A variation we noted in one jurisdiction was to create an independent board, consisting of persons without an affiliation to the jurisdiction issuing the securities or requesting the proposals, to evaluate all proposals and make recommendations and/or final decisions.

Issuing securities via pre-qualified underwriters simplifies the award process by taking away the need to repeatedly review subjective factors such as experience. Thus, the award is based solely on which bid provides the municipality with the best financial package. It also avoids the appearance of any favoritism, a concern that was acknowledged by the Municipal Securities Rulemaking Board (MSRB). MSRB was established by Congress in 1975 to develop rules regulating securities firms and banks involved with underwriting, trading and selling municipal securities, bonds and notes issued by states, counties and cities or their agencies to help finance public projects. It is a self-regulatory organization subject to oversight by the Securities and Exchange Commission.

In 1994, MSRB issued Rule G-37 banning securities firms from engaging in municipal securities business with an issuer (i.e., state, county, city) within two years after certain political contributions have been made to any official of the issuer. The purpose was to protect investors and the public interest by helping to prevent fraudulent and manipulative acts and practices. Securities firms are required to file quarterly reports noting all political entities with which it has done business, and to include in the report all political contributions it or any affiliates have made in the reporting period. These reports are available for public review on MSRB's web site.

Another common thread we noted with jurisdictions contacted was the absence of formal policies and procedures for selecting firms eligible to do business either as managers or underwriters. Also, none indicated a specific process for ensuring those who do the evaluation of securities firms are independent in fact and appearance. Nor did any jurisdiction note that they review the MSRB web site to see if securities firms requesting to do business have made political contributions that would restrict them from participation.

Payment for Underwriter Services

At pages 6-7 of the Virchow-Krause report, observations were made regarding the fees charged by Bear, Stearns in the final transaction and the fees proposed in the original response to the Request for Proposal. The obvious concern raised relates to a variance of $20,398 between the response and the final underwriting charges paid. The Corporation Counsel has reviewed this matter and concludes that because the Board of Supervisors expressly approved the higher amount in the Adopted Resolution Authorizing the Sale of General Obligation Refunding Bond Series 2003A, that there is no legal basis on which to claim recovery of the charges in excess of the original proposal. This approval specifically referenced compensation at the rate of $3.89 per $1,000 of bonds issued, which included the increased payment of $20,398. Because such amount included the higher compensation and was effectively enacted into law, there is no basis upon which to seek recovery. The audit does reference improved communication vehicles for the not uncommon occurrence that there might exist variances, albeit relatively small variances, between the response to an RFP and the final negotiated transaction. Such changes appear to be well-grounded and include drawing specific attention to points of variance before final approval is granted.

Conclusions and Recommendations

Based on our review of the Virchow Krause report, discussions with DAS staff and an assessment of best practices in other jurisdiction, we offer the following recommendations in addition to those identified in the Virchow Krause report:

1. Remove exemption of debt administration services from section 56.30 (2) (a) of County ordinances. Include credit rating agencies only in exceptions language for DAS.

2. The size and composition of evaluation panels should be dictated by the size and nature of the proposals being reviewed. Panelists should include representation of entities outside of the department awarding the contract whenever possible. Panels should also reflect diverse backgrounds appropriate for the process.

3. Amend section 56.30 (5) (a) to require that all documentation related to the award of professional services contracts be retained for seven years. Documentation shall include RFP, memos, proposals, score sheets, analyses, contracts and any other document used in determining the award of a contract. Scoring or ranking of proposals should include rating guidelines and designate a "tie breaker" element of scoring. Score sheets should be signed and dated. Review panel recommendations should be communicated in writing to the

departmental director and should include documentation. This should be reviewed by the Records Retention Committee for appropriate revisions to records retention schedules and compliance with State Statutes.

4. Require that RFPs disclose the criteria and scoring values that will be used in the selection process. Proposals that do not conform to the RFP should be rejected or the reason for not rejecting the proposal should be shared with all proposers.

5. Require that any exception to fees approved by the County Board will be subject to approval by the County Board. If fees are defined within parameters, the Board should be informed of the final amount paid.

6. Provide for independent review of any technical scoring of proposals. Independent scoring of technical elements of proposals should be performed only by individuals, internal or external, with the expertise to provide such analysis. Where necessary, departments shall secure funding for independent scoring by external experts. Any concerns about the evaluation process should be communicated to the department head responsible for final contract recommendations. Department heads are responsible for resolving any such concerns prior to award of the final contract.

7. County-wide training should be provided on records retention requirements, public records, open records requests. Corporation Counsel, in partnership with IMSD and the Records Management Division, has initiated a training program to address these issues.

8. The Procurement Division shall institute training and develop administrative procedures for departments on how to conduct professional services solicitation.

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cc: Committee on Finance and Audit Members